

SUMMARY ANALYSIS OF AMENDED BILL

Author: Davis Analyst: Garnier Bill Number: AB 1991
Related Bills: AB 305, AB 2107,
AB 2131 Telephone: 845-5322 Amended Date: 5-13-98
Attorney: Doug Bramhall Sponsor:

SUBJECT: Health Insurance Deduction Conformity

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED 2-17-98 STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

This bill would conform California law to federal law as it relates to the self-employed health insurance deduction. The federal deduction is presently 45% of the health insurance costs incurred for 1998 and is phased-in to 100% in the year 2007. California presently allows 25% of health insurance costs incurred as a deduction.

SUMMARY OF AMENDMENT

The May 13, 1998, amendment increased the phase-in amounts for the self-employed health insurance deduction from the maximum of 80% in 2006 to the higher current federal amounts. Additionally, the amendment removed language that would have disallowed a deduction for any amounts paid to the National Tobacco Settlement Fund.

EFFECTIVE DATE

This bill would be effective for taxable years beginning on or after January 1, 1998.

SPECIFIC FINDINGS

Except for items stated in this analysis, the department's analysis of the bill as introduced on February 17, 1998 applies.

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
☒ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department/Legislative Director Date
Johnnie Lou Rosas 5/22/98

Agency Secretary Date

By: Date:

Existing federal law provides for a deduction in determining adjusted gross income (AGI) of 45% (effective for 1998) of a self-employed individual's cost for health insurance. Federal law also incrementally allows the deductible percentage to increase to 100% beginning in the year 2007. The percentage is increased as follows:

45% in 1998 and 1999,
50% in 2000 and 2001,
60% in 2002,
80% in 2003 through 2005,
90% in 2006, and
100% in 2007 and thereafter.

This bill would conform California law to federal law as it relates to the self-employed health insurance deduction.

Policy Considerations

Conforming to federal tax law is generally desirable because it is less confusing for the taxpayer. With conformity, the taxpayer is required to know only one set of rules. Conformity also eases the department's administration of the law by utilizing many federal forms and instructions.

FISCAL IMPACT

Tax Revenue Estimate

The revenue losses from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Impact Effective 1/1/98 Enactment Assumed After June 30, 1998 \$ Millions								
1998-9	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
(\$18)	(\$18)	(\$23)	(\$30)	(\$51)	(\$76)	(\$87)	(\$105)	(\$140)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

The revenue impact of this provision would be determined by the number of self-employed individuals who claim additional insurance deductions and the average marginal tax rate applicable to the deduction amounts.

This estimate was developed in the following steps. First, the number of California resident taxpayers who currently claim the self-employed insurance deduction was calculated from returns filed for 1995 (425,000). Secondly, the current deduction amount of 25% was calculated to be \$839 on average for returns filed in 1995, making the average annual health insurance premium \$3,356 (\$839 x 4). Third, the estimated number of qualified taxpayers for 1995 was grown at 5% per year to yield 492,000 qualified taxpayers for 1998. Fourth, the insurance premium was grown at 7%

per year to yield an average \$4,111 insurance premium for 1998. Fifth, the total deduction at 25% was calculated to be \$506 million for 1998 and the amount deducted for health insurance premiums on Schedule-A was calculated to be \$388 million, generating a total deduction amount under current law of \$894 million. At an average marginal tax rate of 4.5% (computed by the PIT microsimulation model for self-employed individuals), the current law revenue loss for 1998 is \$40 million. Sixth, the total deduction was calculated at 45% at a 4.5% marginal tax rate for 1998, generating a \$41 million tax loss and the amount deducted for health insurance premiums on Schedule-A was calculated to be \$13 million, generating a total \$54 million tax loss. These steps resulted in a 1998 estimate of an additional \$14 million tax loss. The 1998-9 fiscal year estimate consists of the 1998 tax loss (\$14 million) and 30% of 1999 reflecting reduced estimated tax payments. Seventh, the total deduction was then calculated at various percentages from 45% phasing up to 100% by the year 2007. Losses were grown to reflect a combined annual growth of 5% (qualified taxpayers) and 7% (premiums) based on current historical averages.

BOARD POSITION

Pending.